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UNCLAS SECTION 01 OF 06 JAKARTA 008686

SIPDIS

SIPDIS

DEPT FOR EAP/MTS AND EB/IFD/OMA  
TREASURY FOR IA-SETH SEARLS  
COMMERCE FOR 4430/GOLIKE  
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO  
DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [PGOV](#) [ID](#)

SUBJECT: INDONESIA - ECONOMIC AND FINANCIAL HIGHLIGHTS JUNE 2006

11. Summary. The Central Bureau of Statistics (BPS) announced on July 3 a slight decrease in year-on-year (YoY) inflation in June 2006 to 15.5 percent. Citing improving macroeconomic trends, Bank Indonesia (BI) cut interest rates by 25 basis points to 12.25 percent on July 6. At their June 14 meeting, Consultative Group on Indonesia (CGI) members pledged USD 5.4 billion of loans and grants to the Government of Indonesia (GOI), more than covering the country's USD 4.3 - 4.6 billion financing gap for 2006. On June 22, Parliament's Special Budget Committee and Minister of Finance Sri Mulyani Indrawati agreed on a revised set of macroeconomic budget assumptions for 2006. On June 22, the GOI announced it would repay half of its outstanding standby reserves loan to the International Monetary Fund (IMF), about USD 3.7 billion, and BI transferred the funds to the IMF the next week. Largely as a result, June foreign exchange reserves at BI fell to USD 40.1 billion. On June 2, the Minister of Finance issued a decree on infrastructure risk sharing guidelines for public-private partnership projects, and the President signed a revised decree on land procurement on June 5. Both measures are designed to help facilitate infrastructure investment. A June 2006 Ministry of Finance report shows that government spending has been slow, with only 31 percent of 2006 funds distributed as of June 7. On June 14 Bank Mandiri, Indonesia's largest state-owned bank, disclosed the names of debtors with non-performing loans (NPLs) exceeding Rp 1 trillion (USD 107.5 million) which account for 60 percent of the bank's total NPLs. The mutual fund industry is recovering from last year's steep sell-off by offering a new class of lower risk products. End Summary.

Inflation Remains High, BI Cuts Interest Rate

12. On July 3, the Central Bureau of Statistics (BPS) announced a slight decrease in YoY inflation in June 2006 to 15.5 percent. Month-on-month (MoM) inflation rose slightly to 0.5 percent from 0.4 percent in May, mainly due to a rise in food prices. Core inflation also increased slightly to 9.6 percent YoY from 9.5 percent in May. Citing improving macroeconomic trends, including declining inflation rates, BI cut short-term interest rates by 25 basis points (bps) to 12.25 percent on June 6, a move widely expected by analysts.

BI Governor Burhanuddin Abdullah said there remains room for further interest rate cuts. "We will cut more aggressively in future when there is less pressure from inflation." Abdullah said he hopes BI can lower benchmark interest rate to 11 or 10 percent by the end of the year, if inflation falls into the single digits.

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Table 1: Inflation Components - June 2006  
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Component	MoM	YoY
Foodstuffs	1.1	17.0
Prepared food, beverages, tobacco	0.3	11.7
Housing, water, electric, fuel	0.3	12.8
Clothing	-0.1	9.8
Health	0.3	7.3
Education, recreation/sports	0.2	8.0
Transportation, communication and financial services	0.1	30.8
Total	0.5	15.5

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Source: Central Bureau of Statistics (BPS)  
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CGI Pledges USD 5.4 Billion for Indonesia,  
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¶3. During their June 14 meeting, CGI members pledged USD 5.4 billion in loans and grants to Indonesia, a sum that will more than cover Indonesia's USD 4.3 - 4.6 billion financing gap for 2006. The commitment consists of USD 3.9 billion in on-budget loans and USD 1.5 billion off-budget loans and

JAKARTA 00008686 002 OF 006

grants. Donors also pledged to help Indonesia rebuild after the magnitude 6.3 earthquake that struck the Yogyakarta area on May 27 and caused an estimated Rp 29 trillion (USD 3.1 billion) in damages and loss. Coordinating Minister for Economic Affairs Boediono said the GOI understands that the CGI's 29 donor organizations would have to consult with capitals and parliaments before finalizing grant commitments for the quake-hit areas. The GOI is planning to provide USD 1.2 billion in earthquake relief and reconstruction from its budget and is requesting USD 300 million from donors.

GOI Revises 2006 Budget Assumptions  
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¶4. On June 22, Parliament's Special Budget Committee and Minister of Finance Sri Mulyani Indrawati agreed on a revised set of macroeconomic budget assumptions for 2006. The budget assumptions influence the projected levels of various revenue and expenditure items in the budget. Parliament and the GOI have also agreed on a set of budget assumptions for the draft 2007 budget that President Yudhoyono will present to Parliament in August 2006. Table 2 outlines revised FY 2006 and preliminary FY 2007 budget assumptions.

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Table 2: 2006 Revised and 2007 Preliminary  
Budget Assumptions  
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	2006 Original	2006 Revised	2007 Preliminary
Budget deficit (1)	0.7	1.3-1.5	0.7-0.9
Oil Price (USD/Barrel)	57	62	57-65
BI Interest Rate (pct)	9.5	12	8.5-9.5
Exchange Rate (Rp/USD)	9,900	9,300	9,000-9,500

Inflation (pct)	8.0	8.0	6.0-8.0
GDP Growth (pct)	6.2	5.9	6.0-6.5

(1) Percent of GDP.

Source: Ministry of Finance

GOI Repays Half of IMF Standby Reserves Loan

15. On June 22, the GOI informed the International Monetary Fund (IMF) of its decision to advance repayment of approximately half of its standby reserves loan under Indonesia's Extended Fund Facility, or USD 3.7 billion. BI made the USD 3.7 billion transfer to the IMF the following week, accounting for most of the USD 4.6 billion decline in Indonesia's gross FX reserves in June. At the end of the month, reserves stood at USD 40.1 billion, down from USD 44.7 billion at the end of May. On June 15, Japan Bank for International Cooperation (JBIC) agreed to waive its condition that a USD 78 million loan from JBIC, due in 2010, be linked to simultaneous repayment of the IMF.

Bank Indonesia Launches Credit Information Bureau

16. On June 29, BI officially launched its new credit information bureau to assist banks in lending and risk management. The bureau collects information on borrowers that financial institutions can access electronically, including borrowers' names, ID numbers, amount borrowed, collateral, and other details. The bureau is operating under BI's directorate for licensing and information. To date, BI has stated that more than 2,600 financial institutions have submitted information on 16.3 million borrowers. BI expects this number to increase significantly in the wake of its June 29 directive requiring all domestic

JAKARTA 00008686 003 OF 006

banks (including small rural banks), finance companies and credit card issuers to submit borrower information to the credit information bureau. Participation by international banks and non-bank financial institutions is voluntary. The lack of accurate borrower information has held back lending for many Indonesian banks. Except through informal negative lists, they were largely unable review a customer's complete credit profile to make informed lending decisions.

Infrastructure Decrees Issued

17. On June 2, Finance Minister Sri Mulyani issued a new ministerial decree (PMK 38/2006) on an "Infrastructure Risk Allocation Framework". The decree covers risk sharing for Public Private Partnership (PPP) infrastructure projects in the energy, transportation, telecommunications, water resources, and housing sectors. The decree covers the following types of risk:

-- Political risk: policies, actions, or decisions by government or state entities that directly and significantly impose financial losses on a business enterprise through expropriation, legal or regulatory change, currency convertability restrictions or funds repatriation prohibitions.

-- Project Performance Risk: Risk associated with project implementation, which includes location risk and operational risk.

-- Demand Risk: When demand for goods or services produced are lower than agreed.

18. Mulyani also said that the government would propose an approximately Rp 2.6 trillion (USD 279.6 million) budget

line item in the revised 2006 budget to finance a three-pronged GOI risk-sharing package potentially including the following items:

--An infrastructure insurance provision, under which the GOI would provide Rp 1 - 2 trillion (USD 107.5 - 215.1 million) to cover the potential liabilities from GOI project risk sharing.

--A possible revolving land acquisition fund. Because of delays in finalizing this fund, the GOI has reallocated to other needs Rp 600 billion (USD 64.5 million) that had been intended for this program.

--A possible government-financed "infrastructure investment fund" still under internal debate. The GOI has said this fund should be finalized soon.

19. On June 5, President Susilo Bambang Yudhoyono signed Presidential Decree No. 65/2006 on Land Procurement for Public Development Purposes. This decree, which revises Presidential Decree No. 36/2005 on the same topic, reduces the GOI's authority to confiscate private property if the owner disagrees with the GOI's compensation offer. The revision also narrows the scope of infrastructure projects that may be categorized as meeting a "public purpose." Decree 36/2005 was criticized for allegedly allowing several instances of forced evictions, intimidation and even physical threats to small property owners. Table 3 outlines changes in the types of projects that the GOI may categorize as meeting a "public purpose."

Table 3: Decree No. 36/2005: Types of Infrastructure Projects that may be defined as meeting a "Public Purpose"

Type	Revised Decree
Railway	Retained
Public Safety	Retained
JAKARTA 00008686	004 OF 006
Airport	Retained
Highway/Toll Road	Retained
Seaport	Retained
Telecommunication Facilities	Removed
Public Building	Removed
Hospitals	Removed
Schools	Removed

Source: Media reports

#### GOI Spending Slow in First Half of 2006

10. On June 28, Ministry of Finance (MOF) issued a budget realization report showing that actual GOI spending up to June 7, 2006 was Rp 203.1 trillion (USD 21.8 billion), or 31.4 percent of the targeted amount. The central government spent Rp 113.6 trillion (USD 12.2 billion) or 25.6 percent of the targeted Rp 427.6 trillion (USD 46 billion). Local government spending reached Rp 89.6 trillion (USD 9.6 billion) or 40.1 percent of the targeted Rp 220.1 trillion (USD 23.7 billion). MOF Director General for the Treasury Mulia Nasution said spending would significantly increase by the third quarter as central and local government spending

units tender and contract projects. Nasution also noted that limited project planning capacity in many local governments is holding back spending.

¶11. Up to June 7, GOI revenues reached Rp 209.1 trillion (USD 22.5 billion), or 33.4 percent of the full year target. Tax revenues make up the largest component of total revenues at Rp 161.5 trillion (USD 17.4 billion) or 38.8 percent of the targeted Rp 416.3 trillion (USD 44.8 billion). Non-tax revenue reached Rp 47 trillion (USD 5 billion) or 22.9 percent of the targeted Rp 205.3 trillion (USD 22.1 billion). Budget surplus reached Rp 5.9 trillion (USD 634.4 million).

#### GOI Swaps Debt

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¶12. On June 27, the MOF swapped Rp 3.1 trillion (USD 333.3 million) of bonds maturing in 2007-09 for bonds maturing in 2012. The old bonds had yields of 12.1 - 12.6 percent, while the new bonds offer yields of 13.2 percent yield. The debt swap is the latest in a series of MOF operations designed to reduce the very amortizations in 2007-09.

#### Bank Indonesia Delays "Single Presence Policy"

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¶13. On June 5, BI Governor Burhanuddin Abdullah announced that BI had decided to postpone the implementation of a "single presence policy" from 2006 to 2008 or later. The policy would prevent a person or a company from owning shares in more than one Indonesian bank. Once BI implements the policy, foreign investors in Indonesian banks, including companies such as Singapore's Temasek Holdings, United Overseas Bank (UOB), Oversea-Chinese Banking Corporation (OCBC), Malaysia's Khazanah, and the United Kingdom's Standard Chartered, would likely have to merge, restructure, or divest their banks. Abdullah reportedly stated that BI is considering other options in consultation with affected banks before creating a stricter regulation requiring divestment.

#### Bank Mandiri "Name and Shame"

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¶14. On June 14, Indonesia's largest state-owned Bank Mandiri

JAKARTA 00008686 005 OF 006

publicized the names of 30 corporate borrowers with non-performing loans exceeding Rp 1 trillion (USD 107.5 million). The bad debtors account for 60 percent of Mandiri's NPLs, which reached Rp 27 trillion (USD 2.9 billion) as of December 2005, or 26.2 percent of its total loans. The surge in NPLs contributed to an 88-percent drop in the bank's net profit in 2005. Among the bad debtors is the Bosowa Group, controlled by Aksa Mahmud, a brother-in-law of Vice President M. Jusuf Kalla. Mandiri President Director Agus Martowardojo said the bank would provide assistance, such as softer repayment terms, for debtors demonstrating goodwill to repay. "For those who do not, the bank plans to take action," Martowardojo said.

#### Mutual Funds Recover?

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¶15. Funds invested in Indonesia's mostly fixed-income mutual funds industry dropped from a peak of Rp 110.8 trillion (USD 11.8 billion) in February 2005 to only Rp 29 trillion (USD 3.1 billion) in December 2005, a decrease of 73 percent. However, Capital Markets Supervisory Agency (BAPEPAM) data show that investment in low-risk, "protected" mutual funds has increased significantly in 2006, driving a recovery in the sector. From March-May 2006, investments in new "protected" mutual funds increased by 110 percent to Rp 6.3 trillion (USD 677 million) from Rp 3 trillion (USD 323 million) in January 2006. In the "protected" funds,

investment managers protect the face or nominal value of investors' funds by investing them in a zero-coupon bond equivalent product (i.e. a low risk government bond) priced at a discount. The managers then invest leftover funds in higher-risk assets, and return any profits to the investors. The "protected" funds appeal to many investors who seek lower risk products after suffering losses in the 2005 mutual fund sell-off.

Table 4: Mutual Fund Growth (Dec 05 - May 06)  
(in Rp trillion)

Type	2005 Dec	2006 Jan	Feb	Mar	Apr	May
Fixed income	13.9	14.4	14.2	14.5	14.6	14.6
Money market	2.1	2.0	2.0	2.3	2.4	2.3
Mixed	5.5	4.8	4.7	4.6	4.8	4.7
Equity	4.9	4.3	4.2	3.9	4.2	4.4
"Protected"	3.0	3.1	2.0	3.7	3.8	6.3
TOTAL	29.4	28.6	27.1	29.0	29.8	32.3

Source: Capital Markets Supervisory Agency (BAPEPAM)

Table 5: Selected Economic, Financial, and Trade Statistics, March - June 2006

	Mar	Apr	May	Jun
CPI inflation (YoY)	15.74	15.4	15.60	15.53
CPI inflation (MoM)	0.03	0.05	0.37	0.45
Rp/USD Exch. rate(1)	9,075	8,775	9,220	9,300
30-day SBI rate (1)	12.73	12.75	12.50	12.50
Foreign Res. (USD bn)(1)	40.1	42.8	44.2	40.1
JSX Composite Index(1)	1,323	1,464	1,330	1,310
Exports (USD billion)	7.45	7.6	8.3	
Percent change (YoY)	2.76	11.9	13.4	
Imports (USD billion)	4.35	4.8	5.1	
Percent change (YoY)	-12.65	-3.7	-2.1	
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Trade Balance 3.10 2.8 3.2

Source: Bank Indonesia, BPS, JSX  
(1) End of period

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